

FEDERAL ENERGY REGULATORY COMMISSION  
WASHINGTON, DC 20426

March 27, 2007

OFFICE OF THE CHAIRMAN

The Honorable Joe Barton  
Ranking Member  
Committee on Energy and Commerce  
United States House of Representatives  
Washington, D.C. 20515-4306

Dear Representative Barton:

I am writing in response to your letter of March 9, 2007 regarding the recently announced acquisition of Texas Utilities Corporation (TXU Corp.) by Kohlberg Kravis Roberts & Co., Texas Pacific Group and Goldman Sachs. You seek reassurance that the proposal will receive scrutiny by the Federal Energy Regulatory Commission (Commission), and that the interests of ratepayers will be adequately protected, and also question whether or not the independence of the Electric Reliability Council of Texas (ERCOT) from Commission jurisdiction is currently warranted and viable.

Your letter includes 11 specific questions related to the proposed TXU Corp. acquisition, including jurisdiction questions and requests for legislative language that would give the Commission broader jurisdiction over ERCOT utilities. Enclosed with this letter are responses to each of the questions you raise. As an initial matter, I want to be clear that the Commission is not requesting additional jurisdiction over ERCOT at this time. We provide legislative language that would expand Commission jurisdiction at your specific request, not because we believe a change in jurisdiction is necessary as a matter of policy. I would also note that at this time we are unable to answer all of your questions with specificity because no filings have been made at the Commission with respect to the proposed acquisition and we do not have necessary information to answer all the questions. Additionally, should filings be made pursuant to section 203 of the Federal Power Act (FPA)<sup>1</sup> or other provisions of the FPA, it would be inappropriate for me or staff to pre-judge any decisions on those filings.

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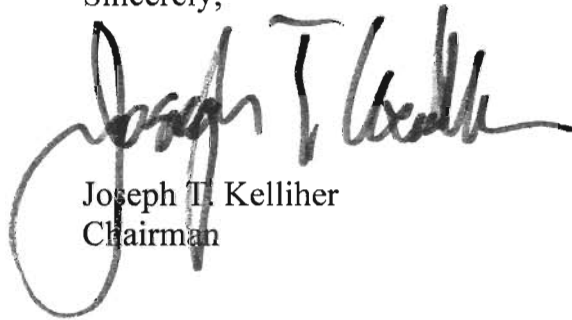
<sup>1</sup> 16 U.S.C. § 824b (2000), *amended by* Energy Policy Act of 2005, Pub. L. No. 109-58, 119 Stat. 594 (2005) (EPAAct 2005).

2007-00052

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I hope this information is useful to you as you review ERCOT-related issues. If I can be of any further assistance in this or any other matter, please let me know.

Sincerely,

A handwritten signature in dark ink, appearing to read "Joseph T. Kelliher". The signature is fluid and cursive, with a large loop at the beginning and a long, sweeping tail.

Joseph T. Kelliher  
Chairman

Enclosure

RESPONSES TO SPECIFIC QUESTIONS RAISED BY  
MR. BARTON'S LETTER OF MARCH 9, 2007

Question 1: What would be the implications of opening ERCOT to the availability of interstate power and to Commission jurisdiction?

Response: As a general matter, the Commission has limited jurisdiction over transmitting utilities and electric utilities that transmit and/or sell power only within the ERCOT region of Texas. For example, while the Commission has jurisdiction under FPA sections 210, 211 and 212 to order certain ERCOT utilities to interconnect and/or provide transmission services to eligible applicants, and in fact has issued a number of orders involving ERCOT utilities under these provisions,<sup>2</sup> section 201(b)(2) of the FPA provides that compliance with any order issued under these provisions does not make an electric utility or other entity subject to the jurisdiction of the Commission for any purposes other than for purposes of carrying out such provisions and applying the enforcement authorities of the FPA with respect to such provisions. Similarly, while the Commission may have authority over ERCOT utilities with respect to certain other provisions added to the FPA by EPAct 2005 (for example, section 203(a)(2) (certain holding company acquisitions and mergers, including certain acquisitions of companies that engage in intrastate transmission and/or wholesale sales) and section 215 (mandatory reliability standards)), section 201(b)(2) jurisdictional exclusions may apply depending upon the specific factual context presented.

If Congress were to give the Commission the same jurisdiction over ERCOT utilities that it has over public utilities that transmit or sell electric energy at wholesale in interstate commerce, as defined in the FPA, the Commission would regulate all rates, terms and conditions of transmission and wholesale sales by investor-owned utilities in ERCOT (whether within ERCOT, within Texas, or across state borders). It also would have clear authority over certain corporate transactions involving investor-owned ERCOT utilities, including certain mergers, dispositions and acquisitions of facilities used for transmission or sales for resale. The Commission might also have authority over certain issuances of securities and holding of interlocking directorates by investor-owned ERCOT utilities. With respect to the availability of interstate power to ERCOT, while some interstate trade already takes place as authorized under the section 210, 211 and 212 orders discussed above, it is possible that additional sales across the ERCOT border would occur if jurisdiction were to change. We note that if the Commission were given increased

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<sup>2</sup> *Central Power and Light Co.*, 17 FERC ¶ 61,078 (1981), as corrected by the Errata Notice issued on November 5, 1981, *order on reh'g*, 18 FERC ¶ 61,100 (1982). See also *Central Power and Light Co.*, 40 FERC ¶ 61,077 (1987).

jurisdiction over investor-owned ERCOT utilities' transmission and sales for resale of electric energy, jurisdiction over retail sales of electric energy and resource procurement would remain with the Public Utility Commission of Texas.

Question 2: Does section 203 of the Federal Power Act (FPA) and the Commission's regulations thereunder apply to any aspect of the proposed transaction? Is this transaction and every aspect of it within ERCOT?

Response: At this time, neither the entities proposing to acquire TXU Corp., nor TXU Corp. nor any of its subsidiaries has made a filing at the Commission under FPA section 203. Without specific information with respect to electric utilities, transmitting utilities and public utilities within the TXU Corp. holding company, and the facilities they own or control, and, importantly, without a detailed understanding of how the proposed transaction will be structured, we cannot determine the scope of possible Commission jurisdiction over the proposed transaction.

We note that section 203(a)(1) applies to certain mergers, acquisitions and dispositions involving public utilities and Commission-jurisdictional facilities used in interstate commerce. We do know that TXU Portfolio Management Company LP is a power marketer with a market-based rate schedule on file at the Commission and is a public utility that owns facilities used in interstate commerce. Thus, a transaction involving this company and its facilities may invoke Commission jurisdiction under FPA section 203(a)(1).

It is also possible that jurisdiction under FPA section 203(a)(2), which was added to the FPA by EPAct 2005, would be triggered. This provision, as interpreted in the Commission's Order No. 669,<sup>3</sup> applies to certain holding company mergers and acquisitions that may involve facilities used in *intrastate* commerce rather than interstate commerce.<sup>4</sup> Section 203(a)(2) also applies to certain acquisitions and mergers involving

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<sup>3</sup> *Transactions Subject to FPA Section 203*, Order No. 669, FERC Stats. & Regs. ¶ 31,200 (2005), *order on reh'g*, Order No. 669-A, FERC Stats. & Regs. ¶ 31,214, *order on reh'g*, Order No. 669-B, FERC Stats. & Regs. ¶ 31,225 (2006).

<sup>4</sup> Sales and transmission of electric energy in "intrastate commerce" generally refers to electric energy that is transmitted and consumed within the same state. However, because of the interconnected nature of the nation's electric grid outside ERCOT, and the physical commingling of electric energy, transmission of electric energy outside ERCOT generally constitutes the transmission of electric energy in "interstate commerce" even if the transmission occurs within a single state. With the exception of

a “transmitting utility” (defined as “an entity . . . that owns, operates, or control facilities used for the transmission of electric energy—(A) in interstate commerce; (B) for the sale of electric energy at wholesale”; in this regard, we note that the Commission recently found that two ERCOT utilities, TXU Electric Delivery Company and CenterPoint Energy Houston Electric, LLC, meet this definition as a result of interstate transactions pursuant to tariffs approved by the Commission under FPA sections 210 and 211.<sup>5</sup> However, as noted above, until we have specific details, we cannot determine the extent to which this provision might apply to the entire transaction or aspects of the transaction.

Question 3: Would this transaction meet the “consistent with the public interest” standard of section 203 of the FPA? Would any cross-subsidization that will result from this transaction be “consistent with the public interest” as stated in FPA section 203?

Response: In determining what is consistent with the public interest under FPA section 203, the Commission’s policy is to examine the effect of a proposed transaction on competition, rates, and regulation. Pursuant to the EPAct 2005 amendments to section 203, the Commission must also find that a proposed transaction will not result in cross-subsidization of a non-utility associate company or the pledge or encumbrance of utility assets for the benefit of an associate company, unless it determines that the cross-subsidization, pledge, or encumbrance will be consistent with the public interest. Since some or all aspects of the transaction may be subject to FPA section 203, it would be inappropriate to pre-judge whether the proposal would be consistent with the public interest; in addition, we do not have sufficient information to make such a determination.

Question 4: Would TXU meet the Commission’s market power tests to be able to sell wholesale energy at market-based rates or would TXU be required to sell at cost-based rates?

Response: Under the Commission’s current test for evaluating market-based rate

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certain direct current interties approved by the Commission under FPA sections 210 and 211 (which allow for the controlled flow of power in a single direction and over which some sales for resale in interstate commerce occur with respect to ERCOT), the ERCOT region is electrically isolated from the rest of the nation’s transmission grid. If ERCOT were to more fully interconnect with the Western or Eastern Interconnection, electric energy would be commingled with energy outside ERCOT and as a physical and legal matter the transmission of electric energy within ERCOT would occur in “interstate commerce” even if the transmission and sale occurred within ERCOT borders.

<sup>5</sup> *Brazos Electric Power Cooperative, Inc.*, 118 FERC ¶ 61,199 (2007).

applications, the Commission examines the applicant's and its affiliates' transmission and generation market power and other barriers to entry. It also ensures that there is no affiliate abuse that could harm captive customers. Except for TXU Corp.'s jurisdictional power marketer (TXU Portfolio Management Company LP), which was most recently authorized by the Commission to sell at market-based rates on November 15, 2006 (Docket Nos. ER06-1515-000, ER06-1515-001 and ER03-506-003), Staff does not have sufficient information to determine whether non-jurisdictional TXU Corp. subsidiaries would meet the Commission's market power test in order to sell at market-based rates. We note that most wholesale power sales of TXU Corp. subsidiaries are not jurisdictional and thus are not subject to Commission reporting requirements. We also note that the Commission currently has pending a rulemaking that is reexamining the circumstances under which public utilities may sell at market-based rates.

Question 5: Does the Public Utility Holding Company Act of 2005 (PUHCA 2005) and the Commission's regulations thereunder apply to any aspect of the proposed transaction?

Response: Unless a public utility holding company has a waiver or exemption from the Commission's PUHCA 2005 regulations, it has to file one or more of the following: notification of holding company status; reports of any material change in facts that may affect an exemption or waiver; compliance with Commission accounting and record retention rules by holding companies and centralized service companies; annual reports by centralized service companies; annual narrative reports by special-purpose service companies. On December 4, 2006, TXU Corp. received a waiver of the Commission's PUHCA 2005 regulations on the basis that TXU is a single-state holding company system. If the proposed transaction constitutes a material change in facts that might affect TXU Corporation's waiver, it must under the regulations file with Commission to retain the waiver. Further, if a person fails to conform to the criteria for a waiver or to conform with any material facts or representations that were presented in support of a waiver, such person may no longer rely on the waiver.

Question 6: Does the proposed transaction, including the commitment to cancel eight planned coal-fired power plants, pose any reliability issues that must be addressed by the Commission or the ERO? Does the Commission have the authority it needs to review such reliability concerns? If not, please provide legislative language that would give the Commission such authority to review this transaction, and others in the ERCOT region.

Response: As a general matter, the Commission does not have jurisdiction over generation facilities except with respect to jurisdictional rates and with respect to its new authority under FPA section 203(a)(1)(D) to review certain transfers of generation facilities. In addition, construction of new power plants (or lack of construction) is

beyond the scope of the new FPA section 215 reliability standards, which apply to operational reliability rather than resource adequacy affecting reliability.<sup>6</sup> With respect to the general issue of adequacy of supply, this is primarily a matter under state jurisdiction. While the Commission, as a general matter, has expressed concerns about the need to maintain adequate supply, it has limited jurisdiction in this area and primarily reviews resource adequacy issues in the context of a specific reserve margin or capacity market issue that relates to jurisdictional rates or market rules involving jurisdictional organized markets. The Commission is not in a position to make a determination regarding whether all the originally planned units were needed to meet the needs of Texas consumers or whether new entrants can supply the power that would have been generated by the cancelled units. The Commission has strived to exercise its jurisdiction in a way that is complementary to the jurisdiction of the states over resource adequacy and it does not appear that any additional FPA legislation is needed at this time.

Question 7: If the Commission believes that it lacks authority to review this proposed transaction under FPA section 203 or PUHCA 2005, please provide legislative language that would give the Commission the authority to review this transaction, and others in the ERCOT region, under FPA section 203 and PUHCA 2005.

Response: I do not believe any legislative changes need to be made to PUHCA 2005. With respect to possible legislative changes to FPA section 203, if the Congress wanted to provide the same FPA section 203 jurisdiction over ERCOT utilities that the Commission has over public utilities, the following is legislative language could be considered:

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<sup>6</sup> Section 215(a) specifically provides that the term “reliability standard” does not include any requirement to enlarge bulk power system facilities or to construct new transmission capacity or generation capacity. Additionally, FPA, section 215(i)(2) reads, “This section does not authorize the ERO or the Commission to order the construction of additional generation or transmission capacity or to set and enforce compliance with standards for adequacy or safety of electric facilities or services.” Section 215(i)(3) reads, “Nothing in this section shall be construed to preempt any authority of any State to take action to ensure the safety, adequacy, and reliability of electric service within that State, as long as such action is not inconsistent with any reliability standard, except that the State of New York may establish rules that result in greater reliability within that State, as long as such action does not result in lesser reliability outside the State than that provided by the reliability standards.”

Insert at the end of FPA section 203:

“203(a)(7). Effective [insert date of enactment or other effective date], notwithstanding any provision of law, including sections 201(b)(2) and 201(e) of this Part and any provision in this Part which exempts from Commission jurisdiction an entity covered by FPA section 212(k), for purposes of this section: (1) facilities used for transmission or sales for resale of electric energy in the State of Texas shall be deemed to be facilities used in interstate commerce; and (2) any person that owns or operates facilities used for transmission or sales for resale of electric energy in the State of Texas shall be deemed to own or operate facilities used in interstate commerce and to be a public utility for purposes of this section, provided, however, that if such person falls within section 201(f) of this Part, it will not be considered a public utility under this section.”

Question 8: Please provide legislative language that would give the Commission the authority to regulate TXU and other utilities in the ERCOT region, under the FPA.

Response: Following is legislative language the Congress could consider if it wanted to give the Commission jurisdiction over ERCOT utilities under the FPA:

“Effective [insert date of enactment or other date], notwithstanding any other provision of law, including sections 201(b)(2) and 201(e) of this Part and any provision in this Part which exempts from Commission jurisdiction an entity covered by section 212(k) of this Part, Parts II and III of this Act shall apply to any person in the State of Texas that owns or operates facilities used for the transmission or sale of electric energy for resale, including transmission or sales for resale of electric energy wholly within the Electric Reliability Council of Texas; provided, however, that Parts II and III shall not apply to entities that fall within section 201(f), except as specifically provided.”

Question 9: How is this buyout affecting customers in Texas?

Response: The Commission does not have sufficient information to answer how the acquisition might affect wholesale or retail customers in Texas. With respect to acquisitions, dispositions and mergers subject to the Commission’s jurisdiction under one or more provisions of FPA section 203, the Commission’s policy is to review effects on retail customers or retail regulation only if the state does not have jurisdiction and has requested that the Commission review the matter. In addition, in looking at the effect on a merger on rates, section 203 applicants generally are encouraged to commit to hold harmless provisions or other measures that will ensure adequate customer protection.

Question 10: How will the KKR buyout and the reduction of power available to Texans affect electricity prices in Texas? (Assume the TXU data presented to the Public Utility Commission of Texas as justification for the need to build its planned 11 power plants is accurate. If you do not believe this information is accurate, please explain why.) Please be as specific as possible addressing short, medium and long-range pricing.

Response: We are unable to answer this question since we do not have sufficient information and data regarding Texas electric prices. Additionally, as discussed in the response to Question 6, the issue of resource adequacy is primarily a matter under state jurisdiction, not Commission jurisdiction. There has been vigorous entry into the Texas generation market. If indeed the planned generating units were needed to meet power demand in Texas, it is entirely possible that new entrants can supply the power that would have been generated by the cancelled units.

We note that if the proposed transaction is subject to the Commission's authority under FPA section 203, as part of their application for Commission approval, applicants will be required to analyze the effect of the merger, consolidation, or disposition on customer rates. Often applicants will propose some method for sharing projected benefits from the merger or consolidation or will offer some form of hold harmless provision to insulate customers from any potential rate effects. Typically this analysis will focus on the effect on existing electricity rates and does not generally consider longer-term pricing issues because of the difficulty associated with making comparisons with what future rates might have been absent the merger or consolidation.

Question 11: Are there any other issues in this transaction that would implicate Commission jurisdiction?

Response: Because of lack of detailed information regarding how the transaction will be structured and details of the companies and facilities involved, we cannot answer this question with certainty. At this time, it would appear that FPA section 203 and PUHCA 2005 regulations might be implicated.